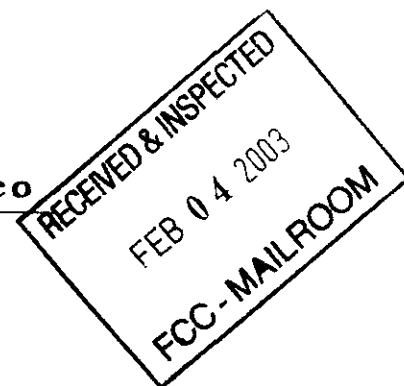




**Commonwealth of Puerto Rico**  
**DEPARTMENT OF EDUCATION**

**César A. Rey Hernández, Ph.D.**  
Secretary



January 30, 2003

CCPacket 02-6

Ms. Jane E. Mago, Esq.  
General Counsel  
FEDERAL COMMUNICATIONS COMMISSION  
445 12th St., S.W.  
Washington, D.C. 20554

**Re: E-Rate Funding for Puerto Rico, Years 4 and 5**

Dear Attorney Mago:

The purpose of this letter is to request from the FCC that it authorize the Schools and Libraries Division (SLD) of the Universal Service Administrative Company (USAC) the immediate availability to Puerto Rico of E-Rate funding for years 4 and 5, in order to complete the development of our "RE-EDUCATE" program.

I. Background

At the request of USAC, during the year 2000 Arthur Andersen LLP conducted an independent review of seventeen beneficiaries of the SLD support mechanism financed by E-Rate funds pursuant to FCC regulations. Our Department ("PRDOE") was one of the beneficiaries subject of the review.

Pursuant to the "Agreed Upon Procedures" between USAC and Andersen, the review was conducted between August 23 and September 1, 2000, and covered the support mechanism's first funding year (year 1), that is, July 1, 1998 through June 30, 1999.

Andersen's report to USAC, dated October 17, 2001 included, in its Appendix B, their findings concerning the PRDOE. Copy of said Appendix B is enclosed herewith as **Exhibit I** of this letter. During their visit, the Andersen auditors inspected the Central Data Center of the PRDOE and physically verified that the equipment funded by the E-Rate Program existed and was being used to support internet connectivity for 708 schools which at the time had an operational T-1 line. They also verified that teachers had been provided with laptop computers which enabled them to access the internet (**Exhibit I**, page B-iv).

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The only finding of this audit that was adverse to PRDOE, is contained in paragraph 11d under Section F (Beneficiary Site Selection) relating to the absence of desktop computers in any of the classrooms of the two schools<sup>1</sup> visited, which prompted the following observation from the Andersen auditors:

Consequently, due to the lack of classroom computers, we ascertained that the PRDOE was not able (as of the date of our site visit) to fully meet the educational objectives (and training requirements) for which E-Rate Funding had been provided. We were, however, able to verify the availability of internet services by accessing the internet using a laptop computer, which we connected to the hub." See **Exhibit I**, page B-vi.

Based upon this finding concerning year 1, USAC wrote a letter to the undersigned dated December 5, 2001, a copy of which is attached hereto as **Exhibit II**. At page 2, USAC cites the above referenced Andersen finding in the context of being "very concerned", demanding that the PRDOE "must provide additional information concerning its ability to use Schools and Libraries Support Mechanism funding".

Specifically, we were requested to produce, "before USAC will commit any additional funding" the following:

1. Detailed information about the acquisition of computers to make use of the connections.
2. A list of the schools where equipment has been installed.
3. Specific information about PRDOE's investments in productivity and curriculum software.
4. The PRDOE progress in delivering professional development (teacher training).
5. The PRDOE's evaluation of any necessary upgrades to the

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<sup>1</sup> There are 1540 schools in the public school system of the Commonwealth of Puerto Rico, treated by USAC as a single, unified "school district" for the purpose of support mechanism financing.

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electrical systems in the schools.

The letter concludes by stating that "USAC will neither commit nor disburse Schools and Libraries Support Mechanism funding to PRDOE's vendors" until it has received and evaluated PRDOE's response to the above information requests.

We immediately responded and explicitly addressed each and every of the above items, both in writing and through a personal presentation to USAC where our compliance with USAC's requests were amply documented. The presentation occurred on January 15, 2002, followed by my letter of January 23, 2002 to Mr. George McDonald, USAC's Vice President for the SLD, **Exhibit III** hereto. The eight page report that served as the basis for the presentation plus exhibits, is enclosed in final form as an appendix to my letter. I respectfully direct your attention to this report, which contains our evaluation and findings on: Status of the Project, Infrastructure needed, Network design, Network management, Electrical and security Infrastructure, Procurement process, Purchase of computers and this administration's integrated approach for recovery and development. Exhibit III is in the possession of USAC since more than a year ago and, as explained in my letter to Mr. McDonald, was submitted less than 30 days after the December 5, 2001 letter came to my attention. This report was updated during personal visits to USAC on April 26 and September 30, 2002. See, **Exhibits IV** and **V** hereto. Together, Exhibits III, IV and V contain: (1) detailed information about the acquisition of computers, (2) numerous lists of the schools where the equipment has been installed, (3) specific information about PRDOE's investments in the project (which to date exceed the funds provided by USAC), (4) detailed information on teachers' training and (5) not just evaluations, but reports on significant infrastructure repairs and upgrades. Although USAC has never responded in writing to my letter of January 23, 2002 (**Exhibit III**) we have received repeated verbal assurances that PRDOE has more than satisfied USAC's requests as stated in their letter of December 5, 2001.

On September 27, 2002 the undersigned formally requested from USAC the immediate availability of funding for years 4 and 5, after having more than fully complied with all of the requests contained in USAC's letter of December of 2001. Copy of said request, which I had the pleasure of hand delivering to you during our meeting of October 1, 2002, is attached hereto as **Exhibit VI**.

## II. PRDOE's Actions concerning the E-Rate Funded Project for Internet access by Puerto Rico's public schools children

As you are aware, the general elections of November, 2000, brought a change of administration in the Commonwealth of Puerto Rico. The undersigned took office as the new Secretary of Education in January, 2001. One of our first concerns was the E-Rate funded project, since our initial impression indicated that very few schools were actually connected and in a position to access the internet. In many schools, the equipment that had been acquired during the previous administration did not appear to have been properly installed and in others the electrical infrastructure was obsolete or inadequate. I ordered a thorough evaluation of the status of this project. To conduct the evaluation, our department hired *ARJ Professional and Consulting Services, Inc.* an independent consulting firm, presided by Mr. Adonay Ramírez Jiménez, a highly respected expert in the

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field. This independent review included an analysis of: (1) The project's direction and administration, (2) Planning, (3) Administrative structure, (4) Usage of resources and control measures, (5) Stage of development, (6) Contracts with vendors and suppliers, and (7) Conclusions and recommendations.

A preliminary report in Spanish was issued on September 18, 2001 **Exhibit VII** followed by a final thorough report dated March 11, 2002. An executive summary in English that we have prepared for your convenience of the final (March) report is attached as **Exhibit VIII**. Based on the preliminary report's findings, by mid-September 2001 we had confirmed our initial impressions and identified the areas where corrective action needed to be taken. Several recovery programs were immediately set in motion to rescue the project. One of them was "Proyecto 400" where we identified 400 schools that were targeted for urgent recovery.

By the time we received USAC's letter of December 5, 2001, which in turn is based on Andersen's findings regarding year 1 that were made in the Summer of 2000, our administration had already been working for several months on a coherent, comprehensive and intense recovery program, based on what we have called a "three-sided approach": The Center (network), the schools and the PRDOE's central office. This is what enabled the undersigned, in compliance with USAC's letter of December 5, 2001, to provide USAC with a detailed report containing our own findings, a coherent plan of action and the status of the project as of January, 2001, **Exhibit III**, above.

Long after having complied with USAC's December 5, 2001 letter we have continued to provide USAC with documented reports of our progress. The latest, was presented to USAC during our visit of January 23, 2003, see **Exhibit IX**. A review of this update shows that since this administration started its recovery program, and without the benefit of a single disbursement of E-Rate funds, we have already installed 103 laboratories, 44 fixed and 59 mobile; 65 new ones are already ordered; another bid has been conducted for mobile laboratories and one is under way at present for additional fixed laboratories. Additionally, 3300 more computers from a special bid have already been received and are in the process of being installed.

Our teacher training program has successfully trained approximately 27,000 teachers, which constitutes 65% of the entire teacher force of the system. 4,000 additional teachers will be trained during the course of this semester.

On the aspect of designing and implementing programs to use technology as a teaching tool, our department has committed and is spending an additional 8.3 million dollars in six new technology integration projects.

Most electrical repair work has been performed or was bidded and the work is in progress. More than \$80 million have been spent in school repairs (Proyecto 1000) in the last two years. Another \$31 million from the Qualified Zone Academy Bonds and \$3.2 million of the Children's Trust Fund have all been spent on infrastructure development, repair and improvements. Full power plants are being built for 86 schools, at an additional cost of \$7 million from the school renovation program.

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A new local area network infrastructure was built at the central offices of PRDOE and the installation of a new server infrastructure has been completed. We developed a very effective school validation process and have set up a help desk system with 43 technicians, 29 of them located at the regions to support schools directly and 14 located at the central office.

Corrective actions have continued consistent with our strategies; bidding regulations are being strictly followed; contract forms have been thoroughly revised to include protective and anti-corruption clauses and our "vendor pushing strategy" has continued.

We have gone from practically no schools connected at the outset of our administration, to more than 600 schools validating regularly, 505 of them with 80% + availability.

At this point, our main concern is that the PRDOE may have well exhausted its capability to continue developing the project without additional E-Rate funding. In the absence of an immediate release of years 4 and 5 funds, our department may have no choice but to re-examine the viability and continuity of the entire project.

Every year lost means that 50,000 Puerto Ricans graduate from high school without the opportunity to overcome the technology divide.

### III. PRDOE's Commitment for the present and the future

As a result of PRDOE's own findings and reports to USAC (and not from the Andersen report) USAC has become aware of our own concerns regarding possible mismanagement or abuse by a vendor providing services for years 2 and 3 (whose contract we cancelled due to our insatisfaction with its performance), and the apparent inadequacy of controls and management supervision by the department for those years.

Recognizing that any possible abuse or misconduct should be thoroughly investigated, our administration has provided documents and our own initial findings to three agencies of the government of Puerto Rico, to wit: (1) An investigation being conducted by the Government Ethics Committee of the Puerto Rico Senate, presided by Senator Cirilo Tirado; (2) A special, non-partisan committee of independent prominent citizens created in January 2001 by an executive order of the Honorable Sila M. Calderón, Governor, entrusted with reviewing past and present governmental transactions to detect any indication of possible corruption and refer to the proper authorities for prosecution when necessary, commonly referred to as the "Blue Ribbon Committee"; and (3) The Department of Justice of the Commonwealth of Puerto Rico, through the office of Chief Commonwealth Prosecutor (Fiscal General) the Honorable Pedro Gerónimo Goyco Amador, who has initiated an investigation at the request of the PRDOE on the services provided by the former vendor whose contract we cancelled. In this regard, since the outset of our administration, we have been cooperating and are committed to continue to cooperate with any investigation by the appropriate agencies of possible abuses, mismanagement or misconduct. See **Exhibits X, XI and XII**.

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Our administration is also committed to assist the pertinent agencies in any effort directed at pursuing fund recoveries from service providers who may be found to have intentionally violated program rules. However, it is important to remember that PRDOE never received funds from USAC. The vendors and service providers submitted their invoices directly to USAC, which in turn reviewed and approved the same, and forwarded payment directly to the vendors. Thus, PRDOE has never been in possession of any funds from the first three funding years.

We intend to continue our practice, established in 2001, to document the goals of our program in comparison with actual achievements, as well as with respect to the current status of educational technology, see **Exhibits III, IV, V, and VII**. We will work with the USAC to identify the differences between what the prior administration represented in the application that would be purchased and what was actually acquired. Also, because so much time has elapsed since our department submitted its requests for years 4 and 5 funding, upon approval of the release of said funds we may well need to work with USAC on service substitution and may need to request from the Commission a waiver of some service substitution restrictions, to the extent that technology has evolved. We will review our years 4 and 5 funding requests not only to ensure compliance with program rules, but also to consult with USAC on the possibility of any service substitution that may be needed.

In 2001 we hired an independent firm to assess what the department had received during funding years 1, 2 and 3 (**Exhibit VII**) which was very helpful in the design of our successful recovery program. We are committed to periodically retain external independent professional firms to evaluate the operational aspects of the project as it develops, and future use of E-RATE funds in light of the expenditures of both PRDOE and E-Rate funds. These independent audits will be conducted on a yearly basis.

In order to ensure that the vendors comply with program rules and as a further step to prevent possible future abuses, we suggest that USAC establish a policy and a procedure for requesting certifications from PRDOE before paying any invoice from the vendors or service providers.

We are committed to continue to strictly enforce the measures taken by the undersigned immediately upon taking office, regarding the procurement process. We not only reorganized the committee in charge of receiving and adjudicating bids (Junta de Subastas) but I also ordered a complete revision of the board's rules and regulations, and next year a review and update of the rules and regulations of the Board of Appeals of the department will be conducted. Likewise, upon my instructions, our Legal Division created a special office for contract review, which during this year has been revising and modifying contract forms and reviewing all acquisition contracts before they are executed, for compliance with the rules and regulations of the Office of the Comptroller and the Office of Governmental Ethics of the Commonwealth of Puerto Rico, other applicable federal or Commonwealth laws and regulations, as well as generally recognized sound management and contractual practices.

In light of the above, there can be no doubt that the Department of Education of the Commonwealth of Puerto Rico can fully meet the educational objectives and training requirements for which E-Rate funding is provided.

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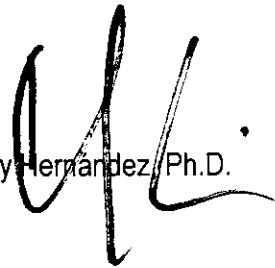
#### IV. Final Remark

More than 660,000 Puerto Rican students have been deprived during the last two years of resources that they are entitled to in order to have an opportunity to overcome the technology divide. People or entities responsible for past misconduct with our RE-EDUCATE Project should continue to be investigated, and if need be, prosecuted. We are committed to continue to provide USAC with the results of our own findings. However, to penalize all of the public school children of Puerto Rico for possible past abuses would be, to say the least, a monumental injustice.

A Commissioner of the FCC, Mr. Michael J. Copps, has been quoted in the media as saying: "If there is fraud and abuse, root it out. But let's not ignore the benefits that this program (E-Rate) has brought to our children...". We cannot agree more. However, in the case of the *Puerto Rican children*, the program has not yet brought them anything for years 4 and 5.

Sincerely,

César A. Rey Hernández, Ph.D.  
Secretary



c: The Honorable Sila María Calderón, Governor  
Commonwealth of Puerto Rico

Mr. George McDonald

USAC Vice President for SLD

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF EDUCATION

César A. Rey Hernández, Ph.D.  
Secretary

Letter to Atty. Jane E. Mago, General Counsel  
to the Federal Communications Commission

January 30, 2003

## **EXHIBIT I**

- "Appendix B" of the October 17, 2001 Independent Public Accountants' Report by Arthur Andersen, LLP., with copy of the "Agreed upon procedures"



## Puerto Rico Department of Education

During the period August 23 to September 1, 2000, we visited the Puerto Rico Department of Education (the "PRDOE") located in San Juan, Puerto Rico for purposes of performing the agreed-upon procedures included as Exhibit I of the Report of Independent Public Accountants dated October 17, 2001 for Application Number 44575. The PRDOE received the following funding from the Schools and Libraries ("S&L") Support Mechanism (referred to as the "S&L Program" or the "Program"):

- One Funding Request Number ("FRN") for internal connections, with a committed amount (discounted portion) of \$11,796,599
- Two FRNs for Internet access, with a committed amount (discounted portion) of \$173,696 and \$2,423, respectively
- One FRN for telecommunication services, with a committed amount (discounted portion) of \$34,249,964

The total committed amount approved for all four FRNs was \$46,222,682 (discounted portion). Disbursements were only made for the internal connection and telecommunication FRNs. No services were obtained under the FRN for Internet services since internal connections were not completed in time to utilize these services. As a result, as of May 11, 2000, only \$21.7 million of the approved amount of \$46.2 million was disbursed for the 11 Service Provider Invoices ("SPI") issued.

The following procedures pertaining to the PRDOE Application Number 44575 were performed.

### A. General Procedures

1. We obtained from the Schools and Libraries Division ("SLD") and reviewed, without exception, the following FCC forms and supporting documentation pertaining to the PRDOE's Funding Year One Application:
  - Approved FCC Form 471 (Schools and Libraries Universal Service Services Ordered and Certification Form) - ("Form 471" or the "Application")
  - Funding Commitment Letter (the "Commitment Letter")
  - Program Integrity Assurance ("PIA") Review Notes related to the Application.

**B. Technology Plan**

2. We obtained and reviewed the approved 1998/99 Technology Plan (the "Technology Plan") noting, without exception, that it established clear goals and strategies (including professional development) for using information technology to improve education. The PRDOE had prepared a budget supporting the Technology Plan and had also developed processes to monitor and track the implementation of technology goals and objectives addressed in the plan.

**C. Understanding the Business**

3. We met with the Director of Information Systems and Technology for the PRDOE and the Special Assistant for the Office of Information Systems and Technology to gain a more detailed understanding of the processes related to the administration of the S&L Program for Funding Year One at the PRDOE. This included how the Technology Plan and Application were prepared and validated; how the Application was structured and how it compared to the approved Commitment Letter. We discussed the management of the E-rate project, including: (1) the results of any communications with SLD regarding the Application process and any differences between the Application submitted and approved; and (2) how the expenditure of approved E-rate funds and the status of the work being completed were monitored. We also discussed the procedures established to monitor claims submitted to SLD in the form of SPIs.

We performed detailed reviews of each relevant process and prepared narrative memoranda documenting the control procedures and process flows for each applicable component process contained within the Funding Year One Program requirements addressed above and determined, without exception, that the PRDOE had established procedures to sufficiently address the Program requirements.

4. We used the information obtained from our detailed reviews to augment the agreed-upon procedures as detailed below.

**D. Program Compliance**

5. To evaluate whether the PRDOE's processes and procedures conformed to the requirements established by S&L Program rules and were sufficient to ensure compliance, we performed the following procedures:
  - a. We selected eight of the 11 disbursements from a disbursements data download provided by SLD. For each of the eight disbursements selected, we obtained and compared the vendor invoice and SPI form and performed the following. No exceptions were noted, except as detailed below:
    - i. We traced and agreed the amount disbursed from the SLD disbursement data download to the corresponding SPI forms to ensure accuracy and completeness.

- ii. We traced and agreed the SPI forms to the corresponding vendor invoices and supporting documentation. We recalculated and agreed the discounted amount reflected on the SPI forms using the approved discount percentage per the Commitment Letter.
- b. Consistent with Year One regulations and procedures, the approved Application did not include a detailed list of equipment and installation costs to be funded through the E-rate Program. Therefore, we did not verify the details of the equipment and services purchased to the Application.
- c. We were unable to verify the equipment purchased with E-rate funds to the schools' asset registers, as no asset registers were maintained for this equipment due to the small amount of equipment purchased for each school. During our site visit we were able to verify, without exception, the equipment purchased and installed to the corresponding equipment packing slips.
- d. We verified, without exception, that the beneficiary had paid their (non-discounted) portion of the E-rate expenditure by agreement of the amounts paid to the vendor payment report and disbursement log. We verified that the correct discount percentage had been applied in accordance with, and by agreement to, the approved discount percentage for SPI claims per the approved Commitment Letter.
- e. We verified that the equipment and cabling had been installed by the cut-off date (September 30, 1999) via review of a database established by the PRDOE. This database is used by the PRDOE to monitor the status of work completed to ensure payments to vendors and claims to SLD are only made for completed work. We reviewed the database for accuracy and completeness by performance of the following procedures. We also noted that the PRDOE asserted (and reaffirmed in a letter to USAC dated September 21, 2001) that all the wiring and certification were completed prior to September 30, 1999.

*Cabling Installation:*

- i. We traced and agreed 38 schools selected from the Data Research Company ("DRC") invoices to the database to verify that the status was listed as "complete" and that the amount was eligible for payment. We noted no exceptions.
- ii. To ensure that the cabling installation was actually completed by the cut-off date for Funding Year One, we reviewed the vendor's testing results (on a DRC CD-ROM) for 32 of the 38 schools selected, and verified, without exception, that the DRC test results were approved as satisfactory prior to September 30, 1999. For the remaining six schools selected, we were unable to verify that the installations were performed by the September 30, 1999 cut-off date for Funding Year One, as the vendor did not complete testing of these installations until after the September 30, 1999 cut-off date.

*Equipment Installation:*

- iii. We tested the accuracy of the PRDOE database regarding completed schools. We traced and agreed 35 of the 38 schools selected from the database to the corresponding school's Puerto Rico Telephone Company's ("PRTC") packing slip and verified that the packing slip had been signed and dated by the school's Director prior to September 30, 1999. For one of the schools selected, we were unable to verify that the installation was performed by the September 30, 1998 cut-off date, as the packing slip was not dated. Equipment for the remaining two schools had not been installed or invoiced as these two schools were closed, therefore, for these two schools this test was not applicable.
  - iv. For 15 additional schools selected from the PRTC invoice for the T1 installations, we verified that the schools had been certified as complete on the Certification Report submitted by Software Design School Cabling (a consulting company hired by the PRDOE to ensure that the installation was appropriately completed).
  - f. We further selected an additional sample of ten schools from the PRDOE database that were listed as completed for both equipment and cabling installation. We verified, by review of the applicable invoices, that they had been invoiced by both companies.
6. During our review of disbursements, we noted that for one vendor, the PRTC, only 745 of the 760 schools covered under the contract had the E-rate funded equipment installed; and only 359 of the 760 schools had a T-1 line installed by September 30, 1999. As a result, the installation charges invoiced were reduced by \$745,393 from the original contracted amount. However, due to the lack of sufficient detail provided within both the contract and the PRTC invoices, we were unable to verify whether this price reduction was consistent with the reduction in the scope of work performed.
7. To ensure the approved funding amount had not been exceeded, we totaled the SPI disbursements and compared this total to the approved funding amount per the Commitment Letter noting, without exception, that the amount disbursed did not exceed the amount approved by SLD.
8. We inquired as to the expenditure of funds to purchase equipment and services in support of E-rate funded expenditures and were advised by the PRDOE that, due to a legal dispute with a potential vendor in the awarding of the supplier contract, they had not yet purchased and installed 100,000 of the classroom (desktop) computers included in the Technology Plan. These computers are necessary to support the E-rate funded expenditures. We noted the lack of classroom computers during our site visit observations, as detailed in Section F., below. However, we were advised by the PRDOE, and further verified through discussion with a teacher at one of the sites visited, that teachers were provided with laptop computers which enabled them to access the Internet. We also noted that other aspects of the E-rate funding requirements were being met.

**E. Competitive Bidding**

9. We reviewed the three contracts (and the contract amendments) relating to the approved Application and verified, without exception, except as noted below, that the following guidelines had been followed:
  - a. We confirmed that the Form 470 had been posted, as required under S&L Program rules, listing the requested equipment and/or services.
  - b. We ascertained through discussion with PRDOE management that they had established appropriate procedures to evaluate and select the most cost-effective bidder based on the responses to their 470 posting. PRDOE management also indicated that all bids received were appropriately evaluated in accordance with state and local requirements.
  - c. We verified that the contracts were appropriately approved by the Department of Education. We were unable to determine whether the three contracts were signed after the allowable contract date based on the date of the 470 posting. The DRC contract was signed but not dated by either the PRDOE or the service provider. We reviewed the contract, noting that the PRDOE's law firm dated the contract as being prepared after the allowable contract date. Additionally, we noted that the two PRTC contracts were signed by the PRDOE and the service provider, but that the service provider signatures were dated after the allowable contract date.

**F. Beneficiary Site Selection**

10. We performed site visits at the PRDOE Central Data Center and two selected schools: Bella Vista Elementary School and Dr. Jose M. Lazaro Senior High School.
11. We visited the two schools and, using the information contained within the corresponding PRTC Packing List (which listed the make and model of the equipment installed), performed the following:
  - a. We physically verified, without exception, that the equipment funded by the Program existed.
  - b. We verified, without exception, the make and model for each item of equipment examined back to the PRTC packing list and invoice.
  - c. We verified, without exception, that the make and model of the equipment purchased and installed had not been substituted, based on physical observation of the equipment and verification to the details per the corresponding PRTC packing slip.

- d. As indicated in Section D.8, we noted that there were no (desktop) computers in any of the classrooms visited at either school. Consequently, due to the lack of classroom computers, we ascertained that the PRDOE was not able (as of the date of our site visit) to fully meet the educational objectives (and training requirements) for which E-rate funding had been provided. We were, however, able to verify the availability of Internet services by accessing the Internet using a laptop computer, which we connected to the hub.
12. We visited the Central Data Center and physically verified that the equipment (Nortel 6480 Concentrator Unit) funded by the Program existed and was being used to support Internet connectivity for each of the 708 schools which currently have an operational T-1 line. We also ensured that the unit was fully integrated with fiber optics to the PRTC's OC48 communications network that is included in the monthly service fee under the contract.



ANDERSEN

INDEPENDENT PUBLIC ACCOUNTANTS' REPORT  
ON APPLYING AGREED-UPON PROCEDURES

Arthur Andersen LLP  
1345 Avenue of the Americas  
New York NY 10105-0032  
[www.andersen.com](http://www.andersen.com)

October 17, 2001

Ms. Cheryl Parrino  
Chief Executive Officer  
Universal Service Administrative Company  
583 D'Onofrio Drive  
Suite 201  
Madison, WI 53719

Dear Ms. Parrino:

At your request, we have performed the agreed-upon procedures enumerated below with respect to the Beneficiaries of the Schools and Libraries Support Mechanism (the "S&L" Support Mechanism or the "Support Mechanism") of the Universal Service Fund, as administered by the Schools and Libraries Division ("SLD") of the Universal Service Administrative Company ("USAC") pursuant to Federal Communications Commission ("FCC") regulations. These procedures were performed solely for the purpose of determining whether schools and libraries receiving support from the S&L Support Mechanism are complying with certain Support Mechanism rules and regulations, in accordance with FCC regulations. This agreed-upon procedures engagement was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The purpose of the S&L Support Mechanism (often referred to as the "E-rate" Program) is to provide financial support to schools and libraries for telecommunication and Internet services and internal connections. Funding approval is dependent on the beneficiaries' eligibility and their abilities to meet and comply with Support Mechanism requirements. The purpose of performing these procedures was to determine (through site visits and physical verification at each of the selected beneficiary sites) whether: 1) these requirements were met and adhered to, and 2) funds received (often referred to as "E-rate funds") were utilized for purposes intended as stipulated in the funding and application requirements. The agreed-upon procedures work program utilized in conducting these site visits is included as Exhibit I.

The agreed-upon procedures were performed for the Support Mechanism's first Funding Year ("Year One"), which covered an 18-month period from January 1, 1998 to June 30, 1999. Subsequent FCC rule changes resulted in an extension of the Support Mechanism first Funding Year, for non-recurring services only, to September 30, 1999.

### Selection of Sample

Based on discussions with SLD and USAC management, it was determined that 18 beneficiary locations would be judgmentally selected for performance of the agreed-upon procedures identified in Exhibit I of this report. The selection process was designed to concentrate on beneficiary Applications with the highest dollar value, emphasizing those with significant internal connections, and others identified as high risk by SLD and USAC management, in addition to a selection from the four primary categories reflecting the diverse demographics (both rural and urban) of the beneficiaries included in the Year One application population – i.e., schools (public and private), school districts, consortia, and libraries.

While performing the agreed-upon procedures at one of the selected sites, we identified certain inconsistencies and irregularities which resulted in USAC engaging Arthur Andersen LLP's Business Fraud & Investigation Services practice to complete and report on their findings. Consequently, the agreed-upon procedures performed and reported herein include only the remaining selected 17 beneficiaries listed below (a more detailed list is included as Exhibit II of this report):

- A. New York City Board of Education, New York, New York
- B. Puerto Rico Department of Education, San Juan, Puerto Rico
- C. Los Angeles Unified Cluster 07 (Grant Van Nuys), Los Angeles, California
- D. Milwaukee School District, Milwaukee, Wisconsin
- E. Los Angeles Unified School District, Los Angeles, California
- F. Chicago Public Schools, Chicago, Illinois
- G. Henderson County School District, Henderson, Kentucky
- H. New York Public Library, New York, New York
- I. Paducah Independent School District, Paducah, Kentucky
- J. Eldorado School District, Eldorado, Illinois
- K. Georgia Department of Adult & Technical Education Office of Public Libraries, Atlanta, Georgia
- L. Milwaukee Public Library, Milwaukee, Wisconsin
- M. Illinois State Board of Education, Springfield, Illinois
- N. Knox County School District, Knoxville, Tennessee
- O. Byrd Middle and Magnet School, Los Angeles, California
- P. St. Charles Borromeo School, New York, New York
- Q. Children of the Peace – Holy Trinity School, Chicago, Illinois



The detailed procedures performed for each application at each individual beneficiary location, and the results of these procedures, are included as Appendices A to Q (Appendix references correspond to the above list of beneficiary applications selected for review). Extended procedures were performed at selected beneficiary locations related to the Year One applications at the specific request of SLD management. The detailed results of these extended procedures are also included, as applicable, in Appendices A to Q.

### Issues Summary

We noted certain exceptions identified as a result of performing the agreed-upon procedures, as summarized below:

- We noted that, in many instances where beneficiaries indicated receipt and installation of services and equipment relating to internal connections prior to the initial cut-off date of September 30, 1999, sufficient documentary evidence was not available to either prove or refute that assertion. Where available, we reviewed the dates and results of systems testing to validate performance prior to the September 30, 1999 cut-off date. We also identified two beneficiaries who were unable to provide sufficient evidence of their approved contracts being executed after the allowable contract dates. Applicants should be aware that retention of appropriate evidentiary documentation for compliance with cut-off requirements is necessary to support eligibility.
- We identified one instance where a contract was executed prior to the allowable contract date and another where internal connections were purchased and installed both before and after the funding year. Applicants should be aware that compliance with cut-off and dating requirements is necessary to ensure continued eligibility.
- One beneficiary was unable to provide or obtain (from the service provider) invoices or other documentation sufficient to support the allocation and breakdown of selected E-rate reimbursements on a Funding Request Number ("FRN") (per school) basis. Internet services, totaling \$2.6 million, could not be linked to specific schools based on the invoices provided by the service provider. In addition, \$35,567 pertaining to six internal connection FRNs could not be tied to individual schools.
- Another beneficiary and the vendor were unable to provide invoices or other documentation sufficient to readily support the correct allocation of (E-rate eligible) billings supporting E-rate reimbursements received, totaling \$1.958 million (discounted). For the same beneficiary, we were unable to physically account for all of the E-rate funded equipment purchases during our site visits.

- An audit of service provider invoices performed by the beneficiary revealed that one of the service providers had submitted invoices for reimbursement that were based on estimated not actual costs. The amounts paid by USAC based on the estimated costs submitted exceeded the actual costs incurred by an estimated \$280,362. The amount of the estimated over-payment identified by the beneficiary had not been refunded to SLD or USAC, as of the date of our findings. However, the service provider has since asserted to the beneficiary (and to the SLD) that payment was rendered to USAC on August 29, 2001.
- The same beneficiary was also unable to provide adequate support for the split of internal connection related charges between (E-rate funded) eligible Bear Entity Applicant Reimbursement ("BEAR") claims and ineligible (non-E-rate related) costs. The beneficiary has acknowledged that the amount submitted to USAC for reimbursement was overstated, but has not been able to substantiate their revised claim amount. We initially estimated that the beneficiary had allocated approximately 77% of the total vendor billing to compile the E-rate eligible amounts subsequently submitted to and reimbursed by SLD (at the appropriate discount rate). The beneficiary now claims that they should have used an allocation rate of 55% to determine the E-rate eligible amounts to be submitted. However, based on the limited information provided, we are unable to support the 55% allocation rate now estimated by the beneficiary, and consequently, are unable to determine the amount associated with this issue. This same beneficiary also received reimbursement totaling \$456,572 (discounted) which pertained to work initiated, and for which payment was rendered (to the vendor), prior to commencement of the Funding Year (January 1, 1998). In addition, the beneficiary also received reimbursement totaling \$1.965 million pertaining to installation costs claimed for work performed after the September 30, 1999 cut-off date.
- For another beneficiary, we identified errors in the calculation of the discounted amounts on two Service Provider Invoices totaling \$804,751 (pertaining to two FRNs). The total discounted amount submitted to (and paid by) SLD for reimbursement of these two invoices amounted to \$665,105. The correct discount amount (at 75%, the approved discount percentage) should have been \$610,982, resulting in a net excess claim amount of \$54,123. It should be noted that for each of the two FRNs, the amounts disbursed by SLD (\$560,516 and \$104,589,) were less than the approved FRN funding amounts (totaling \$1.1 million and \$0.2 million, respectively).
- We noted that one beneficiary had not received reimbursement from the service provider in the amount of \$1,620 for part of one BEAR.

- We noted that another beneficiary submitted its BEAR forms based on the cost estimates submitted with their application, rather than on the actual costs incurred. This resulted in an estimated over-claim of funds on one FRN (due to the actual costs being less than the original estimates), totaling \$25,897. An excess claim was also filed on another FRN, resulting in part from estimates (in excess of cost) being submitted, but also due to the inclusion of an amount related to a 10% service charge billed by the state-operated agency handling the vendor payments. This service charge is not an eligible cost. The aggregate estimated amount at issue for this second FRN (as a result of the 10% service charge and the estimated cost in excess of actual cost being claimed) is \$18,790.
- For the same beneficiary, we noted (based on our invoice review of one of the FRNs) that many of the invoices supporting the BEAR reimbursement of this FRN pertained to work performed by a vendor who was not an authorized service provider under this application (the "unauthorized vendor"), rather than the approved vendor who was in fact the recipient of the funds received from SLD (totaling \$765,802, discounted). We further identified that only \$363,948 (discounted) of the \$765,802 paid by SLD to the approved vendor (and paid by the approved vendor to the beneficiary) was for services actually provided by the approved vendor. The balance of \$401,854 was for work performed by the unauthorized vendor. The approved vendor subsequently provided a letter stating that they had requested the unauthorized vendor to provide the required contracted equipment and services directly to the beneficiary, since the equipment and services the beneficiary required at the time were at a price the approved vendor could not then agree to. This letter further stated that since that time a distribution agreement was entered into between the two vendors that allows the approved vendor to directly provide the unauthorized vendor's equipment to the beneficiary. However, neither vendor has provided any evidence of the contract execution date, terms or coverage relating to the subsequent agreement referred to in the letter. Also, we noted that the unauthorized vendor was paid by the beneficiary prior to the BEAR being submitted to USAC for reimbursement to the approved vendor.
- For one beneficiary, we were advised that, as of the date of our site visit and review, the school had not yet paid its (non-discounted) portion of E-rate funded equipment and services due to the school not being satisfied with the network connectivity test results. A similar situation was noted for another school that had not paid the non-discounted portion of the invoice for E-rate funded services as of the date of our review and site visit. In both situations, the SLD had funded the discounted portion and not been notified that the remaining balance (the non-discounted portion) was being withheld. Beneficiaries should be aware that retention of documentation supporting payment of the non-discounted portion of E-rate funded equipment and services is necessary to support Program compliance.

## AGREED-UPON PROCEDURES WORKPROGRAM

The Schools and Libraries Division ("SLD") of USAC currently administers the universal service support mechanism for eligible schools and libraries pursuant to Federal Communications Commission ("FCC") regulations. Certain aspects of program administration are outsourced to the National Exchange Carriers Association ("NECA") and subcontractors retained by NECA.

### Agreed-upon Procedures Objectives

This agreed-upon procedures review of the Schools and Libraries Support Mechanism (the "S&L" Support Mechanism or the "Support Mechanism") beneficiaries is designed to achieve the following objectives relating to Funding Year One ("Year One") applications for selected beneficiaries: (1) detect waste, fraud, and abuse of S&L Support mechanism funds; (2) serve as a deterrent to S&L Support Mechanism abuse; and (3) generate insights about the quality of S&L Support Mechanism implementation by Schools and Libraries ("S&L") beneficiaries.

### Overall Objectives

The Schools and Libraries Committee of the USAC Board of Directors and USAC have identified certain support mechanism and agreed-upon procedure review objectives to further support the implementation of the Schools and Libraries universal service support mechanisms at the beneficiary level and to help assure that schools and libraries receiving support from the Schools and Libraries Support Mechanism (also referred to as the "E-rate" Program) are in compliance with Support Mechanism rules and regulations. The objective of the agreed-upon procedures review is to ascertain whether or not appropriate controls, procedures and processes have been developed and implemented by the beneficiaries to ensure compliance with Support Mechanism rules and requirements, as they relate to Year One applications and funding reimbursement processes at the beneficiary level. A representative sample of beneficiaries will be selected for a site visit and detailed review. The purpose of each beneficiary site visit and review will be to determine whether established procedures (at the beneficiary level) sufficiently address the following criteria:

- (1) A process has been established to select the most cost effective Service Provider. In situations where alternative Service Providers were selected (i.e., other than the most cost effective) sufficient reasons have been documented.
- (2) Bidding requirements have been established and adhered to in accordance with S&L Support Mechanism rules.
- (3) Equipment or services provided and funded were consistent with what was represented on the Year One Application and were provided or installed within the approved Year One installation period, as extended, of January 1, 1998 to September 30, 1999.

We were not engaged to perform an examination, the objective of which would be the expression of an opinion on the beneficiaries' compliance with S&L Program rules and regulations. Accordingly, we do not express such an opinion. Had we been engaged to perform additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of the SLD, USAC, and the FCC and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of those procedures for their purposes. However, this report is a matter of public record and its distribution is not limited.

We have no responsibility to update our report beyond the date of this letter.

*Arthur Andersen LLP*

Roseland, New Jersey

## Schools and Libraries Support Mechanism Selected Beneficiaries

Ref. No.	Application No.	Applicant	State	Approved Funding Amount	Funds Disbursed*	FRNs
A.	112571	NEW YORK CITY BOARD OF EDUCATION	NY	\$ 66,452,734	\$ 58,413,033	2,836
B.	44575	PUERTO RICO DEPARTMENT OF EDUCATION	PR	46,222,682	21,730,122	4
C.	30774	LOS ANGELES UNIFIED CLUSTER 07 (GRANT VAN NUYS)	CA	3,528,266	3,375,177	4
D.	110953	MILWAUKEE SCHOOL DISTRICT	WI	23,827,148	20,934,325	304
E.	102615	LOS ANGELES UNIFIED SCHOOL DISTRICT	CA	8,772,895	4,743,303	3
F.	62505	CHICAGO PUBLIC SCHOOLS	IL	15,974,070	9,368,533	1
G.	111774	HENDERSON COUNTY SCHOOL DISTRICT	KY	2,217,538	1,743,383	14
H.	70302	NEW YORK PUBLIC LIBRARY	NY	6,514,146	5,066,764	61
I.	111582	PADUCAH INDEPENDENT SCHOOL DISTRICT	KY	1,013,503	891,968	18
J.	13756	ELDORADO SCHOOL DISTRICT	IL	52,777	30,293	15
K.	11911	GEORGIA DEPARTMENT OF ADULT & TECHNICAL EDUCATION OFFICE OF PUBLIC LIBRARIES	GA	3,071,845	1,558,709	208
L.	79510	MILWAUKEE PUBLIC LIBRARY	WI	1,854,368	1,280,231	7
M.	112173	ILLINOIS STATE BOARD OF EDUCATION	IL	3,191,095	3,097,986	7
N.	107041	KNOX COUNTY SCHOOL DISTRICT	TN	2,214,687	1,967,021	148
O.	31378	BYRD MIDDLE AND MAGNET SCHOOL	CA	375,200	358,255	1
P.	95603	ST. CHARLES BORROMEO SCHOOL	NY	53,873	35,361	3
Q.	42772	CHILDREN OF THE PEACE - HOLY TRINITY SCHOOL	IL	<u>45,744</u>	<u>31,320</u>	3
TOTAL				<u>\$185,382,571</u>	<u>\$134,625,784</u>	

\* Funds disbursed are as of the dates noted per the individual report appendices.

- (4) The beneficiary had adequate resources, as certified, to use the discounted services or equipment for which funding had been provided.
- (5) The beneficiary had an approved technology plan as certified.
- (6) The approved funding and corresponding service were provided to the correct recipient in the correct amounts.
- (7) Payments to beneficiaries or Service Providers were made in accordance with approved funding requirements and did not exceed amounts approved per the associated Funding Commitment Letter (the "Commitment Letter").
- (8) The services obtained were used for the purpose for which the funding had been provided as certified on the Application.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF EDUCATION

César A. Rey Hernández, Ph.D.  
Secretary

Letter to Atty. Jane E. Mago, General Counsel  
to the Federal Communications Commission

January 30, 2003

## **EXHIBIT II**

- USAC LETTER TO PRDOE - DECEMBER 5, 2001





**Universal Service Administrative Company**  
Schools & Libraries Division

George McDonald  
USAC Vice President, SLD

17,760  
6P  
1/8/02

December 5, 2001

Cesar A. Rey Hernandez  
Secretary  
Puerto Rico Department of Education  
P.O. Box 190759  
San Juan, Puerto Rico 00919 0759

RE: Presence of Computers to Use Schools and Libraries Universal Service Support  
Mechanism Discounted Service

Dear Mr. Rey:

The Puerto Rico Department of Education (PRDOE) requested Schools and Libraries Universal Service Support Mechanism discounts for Funding Year 1 (January 1, 1998, through June 30, 1999) for telecommunications services, Internet access, and internal connections, and \$46.2 million in discounts were approved covering all three service categories. Of that total, \$21.7 million has been disbursed for telecommunications and internal connections.

During our review of PRDOE's request for Funding Year 1 discounts, SLD asked for evidence that PRDOE had "secured access to all of the resources, including computers, training, software, maintenance, and electrical connections necessary to make effective use of the services purchased as well as to pay the discounted charges for eligible services," as it had certified on FCC Form 471.

Based on the information provided in response to our request, we concluded that PRDOE had demonstrated that there would be the necessary resources (including computers) to make effective use of the discounted service and approved the requests.

As you know, PRDOE was selected for a beneficiary review during the summer of 2000 to be conducted by Arthur Andersen, LLP on behalf of the Universal Service Administrative Company (USAC). The final report on the beneficiary review of PRDOE concluded as follows: